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Market Review Monthly

February 2025

A business of Marsh McLennan

Key takeaways

- After announcing tariffs on China, Canada and Mexico, the US has imposed 25% tariffs on steel and aluminium imports and plans to introduce reciprocal tariffs on all trading partners.
- The Reserve Bank of Australia (RBA) cut the cash rate by 25bps to 4.10%. This is the first rate cut by the RBA since 2020.
- Australian employment remained solid in January, with 44,000 jobs added. The unemployment rate rose slightly to 4.1%.
- The US Q4’24 corporate profit season is nearly complete, with 75% of S&P 500 companies reporting positive earnings surprises.
- We favour International listed property where fundamentals are broadly healthy, and valuations are attractive. We also favour Japanese shares due to the economic growth rebound and solid earnings growth.
- Domestically, we favour Australian sovereign bonds over cash, with interest rates likely to have peaked this cycle.

Upcoming

1. Australian labour market announcement (20th March) – The Australian labour market remains stronger than the RBA would be comfortable with.

2. US Federal Reserve (FED) rate decision (20th March) – Will the Fed see tariffs as a threat to inflation or growth?

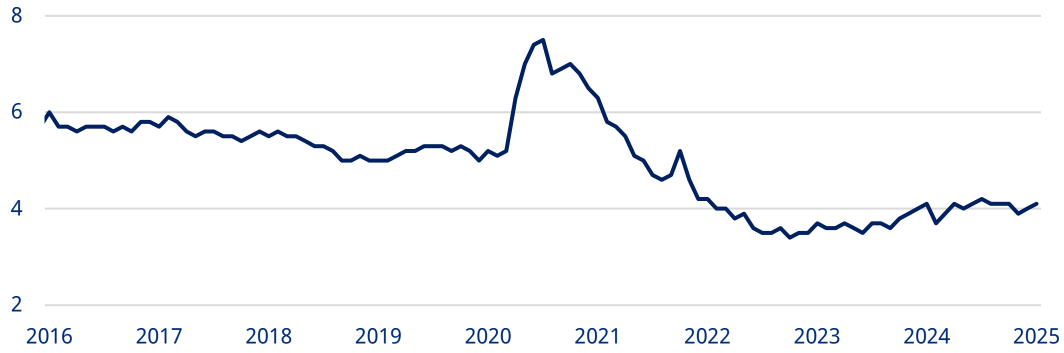
3. US Institute for Supply Management (ISM) manufacturing and service surveys – Will tariff concerns lead to a downturn in US business activity?

Economic review

The RBA cuts rates by 0.25% to 4.1%.

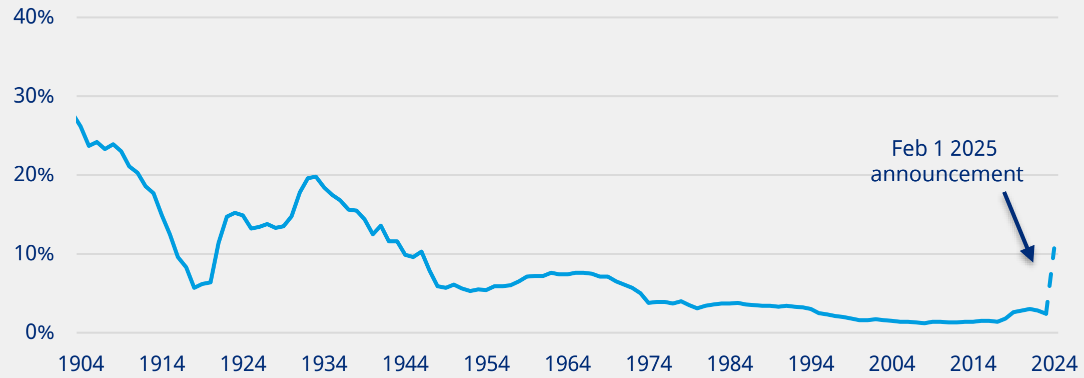
- The RBA cut the cash rate by 0.25% to 4.10%, marking the first rate cut since 2020. This cut was widely expected, as the RBA noted that "inflationary pressures are easing a little more quickly than expected".
- However, the RBA cautioned against expecting further easing as the labour market conditions remain relatively tight, evidenced by limited labour supply and stagnant productivity growth.
- Australian employment remained solid in January, with 44,000 jobs added. Unemployment slightly increased to 4.1%. Wage growth weakened in Q4'24, slowing to 3.2% Year on Year (YoY) from the previous 3.5%.
- Household spending was up 0.4% Month on Month in December and the rise in household spending over Q4'24 may concern the RBA given the strength in the labour market.

Australia Unemployment Rate %



Source: Bloomberg, Mercer

US average tariff rate on total imports



Source: Bloomberg, Mercer

President Trump imposes tariffs on US Steel and Aluminium imports

- The US has imposed a 25% tariff on steel and aluminium imports. Currently, 25% of steel consumed in the US is imported, with the three largest exporting countries being Canada, Brazil and Mexico.
- President Trump announced that the next steps in his tariff plan will be reciprocal tariffs on all trading partners. These tariffs would be customised for each country and will match other countries' tariffs on the US, as well as address any non-tariff barriers believed to disadvantage the US.
- US Consumer Price Index (CPI) for January was higher than expected. The increases were widespread and not driven by shelter, unlike previous months.
- The Bank of England cut interest rates by 0.25% in February, noting significant progress in reducing inflation over the past two years. Domestic inflationary pressures remain somewhat elevated, and UK economic growth has weakened.

Market review

Share markets were down in February

- International shares had a slightly negative return in February, down -0.9% due to disappointing US economic data, rising inflation and investors' sentiment around President Trump's economic plans.
- Australian shares performed worse than their global counterparts, down -3.8%. This underperformance was mainly due to disappointing earnings results from large cap shares in the banking sector.
- International REITS returned 2.0% in February and Australian REITs were down -6.1% as there was some capital raising in the REIT sector.

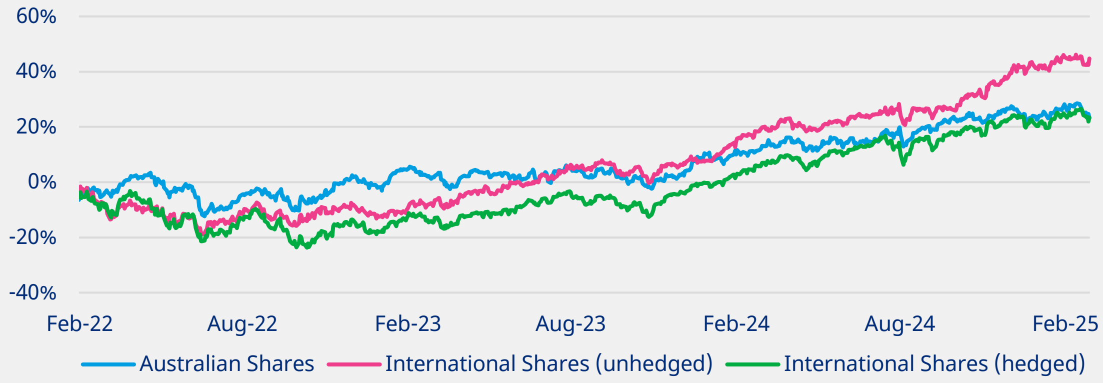
Fixed income markets performance positive

- International sovereign bonds were up 1.0% in February, as bond yields fell over the month driven by softer-than-expected US economic data.
- Australian sovereign bonds were up 0.9% in February, as RBA comments cautioning expectations for additional interest rates cuts caused bond yields in Australia to stay elevated compared to international yields.
- International credit was up 1.4%, although credit spreads were unchanged over the month, with the fall in absolute yields contributing to the positive return.

Australian Dollar experienced fluctuations in February

- The Australian dollar (AUD) was unchanged over the month but was volatile during the month. The AUD/USD traded between 0.61 and 0.64 in February.

Cumulative asset class returns



Source: LSEG DataStream; MSCI. Data provided 'as is'. Details on chart constituents can be found on last page.

Market Insights

Australia: No expectation that the RBA will rush into further rate cuts

- While the RBA cut rates at their February meeting, the labour market is likely stronger than the RBA would prefer. Therefore, we do not expect the RBA to rush into further rate cuts. Further easing will likely depend on sustained signs of a loosening labour market and/or weakening wage growth.
- While unemployment remains low, both wage growth and job vacancies continue to fall, which suggests we should see the labour market begin to soften and a modest rise in unemployment in 2025.
- We continue to expect growth to remain weak, as higher interest rates and cost-of-living pressures are likely to keep consumption suppressed.
- Domestically we favour Australian sovereign bonds over cash, with interest rates likely to have peaked this cycle.

International: Interest rate decreases expected to continue

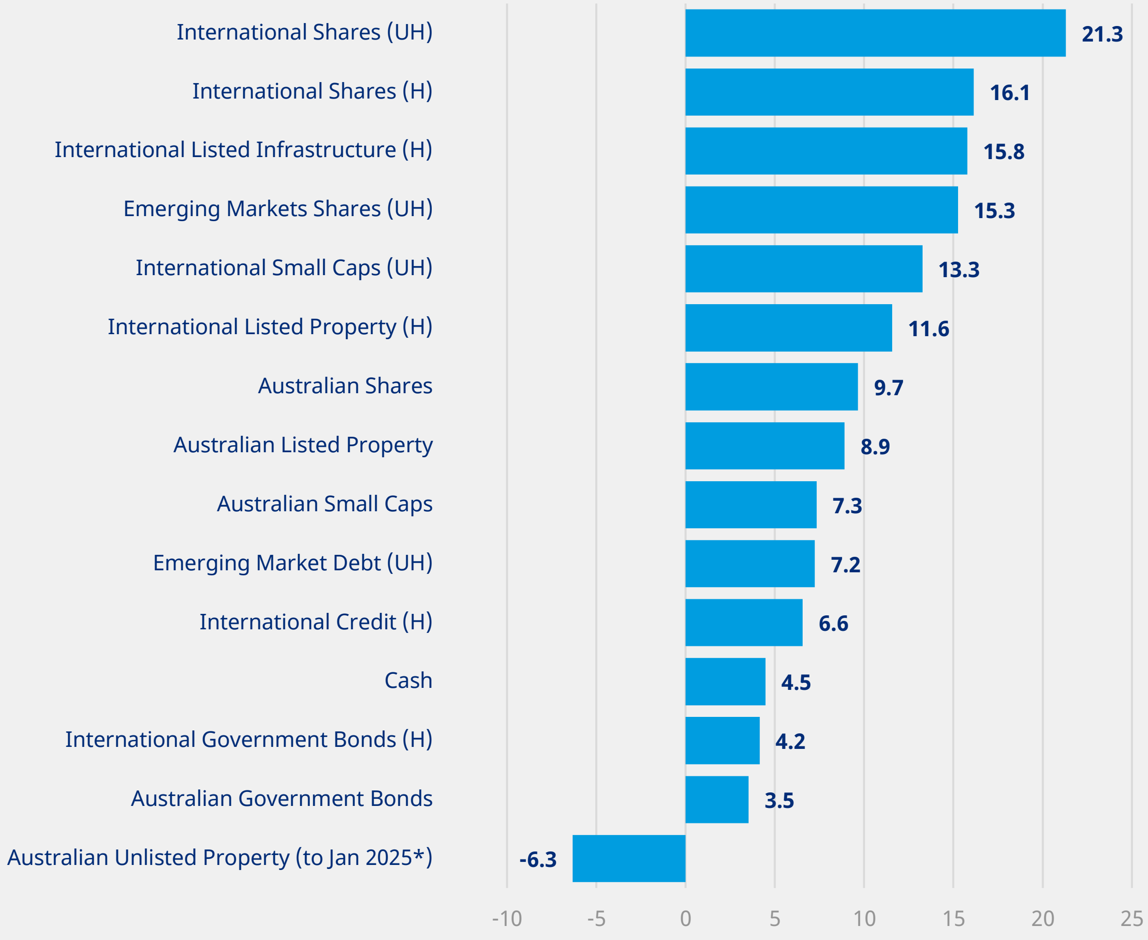
- It is likely tariffs will have a one-off impact to inflation, and Central Banks are expected to treat it as such. We believe that President Trump ultimately wants to strike a deal with economic partners; however, the longer the trade war continues the larger the implications are for economic growth.
- Central Banks around the world are likely to continue to cut rates, as inflation moderates but at a slower pace. The exception is Japan, where we expect interest rates to rise as it emerges from a multi-decade deflation period.
- Japan is likely to continue to do well economically, driven by income growth and continued investment in capital expenditure. We continue to favour Japanese shares relative to other developed country share markets.
- We favour International listed property, as fundamentals are broadly healthy and valuations are attractive. We also favour Japanese shares due to the potential growth rebound and solid earnings growth.

Performance

Market performance February 2025

Data source: LSEG Datastream. Data provided 'as is' . Details on chart constituents can be found on last page

Market performance 12 Months to February 2025



Data source: LSEG Datastream. Data provided 'as is' . Details on chart constituents can be found on last page

Asset class

▼ Australian Shares

- Australian shares performed worse than their global counterparts, down -3.8%.
- In February, there were disappointing earnings results in the Australian share market; particularly from the banking sector, which reported pressure on their net interest margins.
- The utilities sector was the best performer, rising 2.7% in February; likely benefiting from the lower international bond yields, due to their sensitivity to borrowing costs. The consumer staples sector followed closely, up 1.5% over the month.
- The information technology sector was the worst performer in Australia, dropping -12.3% over the month; driven by WiseTech Global Ltd, which fell -27.7% over the month.

▼ International Shares

- International shares (hedged) had a marginally negative return in February, down -0.9%; due to disappointing US economic data, rising inflation and investors' sentiment around President Trump's economic plans.
- International shares (unhedged) also fell, but by only 0.4%, as the AUD also declined over the month.
- International small-cap shares underperformed the broader indices, declining by -3.0%.
- Emerging market shares were up 0.8%, as investors found value in Chinese tech stocks following DeepSeek's AI research announcement from the previous month.
- In February, the best performing sector in International shares was consumer staples, up 5.2%, while the worst performer was consumer discretionary, down -6.4%.

▲ Fixed Interest

- International sovereign bonds were up 1.0% in February, as bond yields fell. The softer-than-expected US economic data caused the drop in international bond yields. US CPI for January was higher than expected, and the US Services Purchasing Managers' Index (PMI) declined, with decreases in both the new business and employment components indicating a softening in the US services sector.
- Australian sovereign bonds were up 0.9% in February, as RBA comments cautioning expectations for additional interest rates cuts are likely to have caused bond yields in Australia to stay elevated compared to international yields.
- International credit was up 1.4%, although credit spreads were unchanged over the month, with the fall in absolute yields contributed to the positive return.

▲ Real Assets

- Interest rate sensitive assets, International listed property and International listed infrastructure, performed well, as International sovereign bond yields fell over February.
- Australian listed property fell over the month, due to capital raising in the sector.

▼ Currency

- The AUD/USD was mostly unchanged in February. The AUD versus other currencies fell over the month. This reflects most major currencies had a positive month versus the USD, with the AUD not benefitting from this.

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Chart Constituents

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
International Shares (UH)	MSCI World ex Australia	Net Index
International Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
International Small Caps (UH)	MSCI World Small Cap	Net Return
Emerging Markets Shares (UH)	MSCI Emerging Markets	Net Index
Australian Unlisted Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian Listed Property	S&P/ASX 300 A-REIT	Total Return
International Listed Property (H)	FTSE EPRA/NAREIT Developed Hedged	Net Return
International Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Net Return
International Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
International Government Bonds (H)	Bloomberg Global Treasury Hedged	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Where a lag exists, the performance start and end dates shift accordingly.*
- *Total Return: Total Return Index with Gross Dividends.*
- *Net Index: Total Return (Net Dividends Reinvested).*

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